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U.S. CORPORATE ACCOUNTABILITY IN THE ESG ERA

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ABSTRACT

The focus of corporate governance on Environmental, Social and Governance ("ESG") issues has grown exponentially in recent years. The phenomenon has a global nature, and the COVID-19 pandemic has accelerated the demand for corporate leaders to take ESG seriously. In the United States, ESG-related proxy proposals and new rules on board diversity adopted by Nasdaq illustrate this change in the focus of corporate governance away from narrow attention to shareholder wealth maximization.

While practitioners and scholars have already analyzed in great detail both the practical and theoretical aspects of this paradigm shift, it is unclear whether the U.S. legal system currently provides the optimal framework for the complete realization of ESG goals. This article explores the potential for effective integration of ESG objectives into U.S. corporate law, bankruptcy practices, and securities regulation. The article suggests that, ultimately, what underlies the focus on ESG objectives is rising demand for greater accountability of corporations and their leaders, and that reputational incentives and activist campaigns have higher potential than the existing legal infrastructure.

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TABLE OF CONTENTS

INTRODUCTION

CORPORATE governance evolves with time, and a wide range of cultural, political, and historical factors influence its transformation. Nevertheless, as noted by some scholars, there is a cyclical element to its evolution.[1] The latest trend in corporate governance has seen a revival of a more stakeholder-oriented approach, and the concept of corporate purpose itself has expanded to include

[1] Ronald J. Gilson & Curtis J. Milhaupt, *Shifting Influences on Corporate Governance: Capital Market Completeness and Policy Channeling*, 12 HARV. BUS. L. REV. 1, 3 (2022).

a broad array of constituencies, including communities.[2] Environmental, Social and Governance ("ESG")[3] goals have become the focus of the latest shift, and recent developments in history seem to have increased the need to address these objectives more rapidly.

Yet, while a great deal of attention has been devoted to this debate and to the creation of mechanisms that would allow firms to inform their business models in light of these developments, examination of a number of settled corporate practices suggests that there are obstacles to realizing these objectives.[4] This paper aims to investigate the constraints imposed on the full actuation of ESG goals, specifically by analyzing the "safe harbors" that currently stand in the way of full corporate accountability in the United States. While corporate boards are investing considerable effort in adapting their approaches to focus on ESG issues, standards to evaluate corporate misconduct and fiduciary duties—as well as the tools provided by bankruptcy law—offer directors and officers (and even third parties) shelter from liability for decisions and oversight failures that harm the public.

This paper looks at how the new climate surrounding corporate governance might find recognition in courts and in the current regulatory framework. Will the current mixture of shareholder primacy and director primacy survive, or will a new dimension emerge? Adopting the view of corporate governance cyclicality, I suggest that although corporate governance may be adapting to the current social environment by reflecting the latest ESG trends, this is likely a short-term phase. In fact, some recent empirical work casts doubt on the idea that pursuing ESG goals increases revenues.[5] Nevertheless, corporate reputation has undisputedly come under increased

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2 *See* David J. Berger, *Reconsidering Stockholder Primacy in an Era of Corporate Purpose*, 74 BUS. LAW. 659, 660-63 (2019); *see also* David J. Berger, *In Search of Lost Time: What If Delaware Had Not Adopted Shareholder Primacy?*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? 48, 60 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019).

3 ESG is also referred to as "EESG," which includes concern for employees. *See* Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* 6 (Univ. of Pa., Inst. for L. & Econ. Rsch., Working Paper No. 19-39, Harv. John M. Olin Discussion Paper No. 1018, 2020), https://ssrn.com/abstract=3461924.

4 *See* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 142, 146-47 (2020).

5 David F. Larcker et al., *Seven Myths of ESG*, STAN. CLOSER LOOK SERIES, Nov. 4, 2021, at 2 (2022); *see also* Bradford Cornell & Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?*, 1 J. IMPACT & ESG INVESTING 76, 76, 83-84, 89-90 (2020).

pressure over the last few years, suggesting that profitability is not the sole consideration. ESG objectives call on corporations to become better citizens, to adhere to a stricter ethical code, and to align their activities with contemporary social values. The question that follows is whether the "ESG channel" is the appropriate means to achieve these goals. I review the *status quo* and conclude that, in the absence of greater corporate accountability, investors' close attention to ESG is likely to fade and revert to a renewed version of shareholder primacy.[6]

I. ESG'S DEEPER MEANING: A FACADE OF DEMANDS FOR ACCOUNTABILITY?

Several indicators demonstrate the degree to which focus on ESG has grown in recent years.[7] Numerous regulators globally have worked to embrace the new demands for increased sustainability-driven policies and to begin reforming regulatory frameworks to promote ESG goals.[8] In addition, recent events have intensified the pressure on corporations to take action.[9] The COVID-19 pandemic and the already tangible impact of climate change have further exacerbated the concerns of the international community. Other events such as the rise of populism, the impact of social media on society, the #MeToo

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6 Jacob Wolinsky, *Is ESG For Equity Investing a Bubble? This Survey Suggests It Could Be*, FORBES (Nov. 10, 2021, 2:24 PM), https://www.forbes.com/sites/jacobwolinsky/2021/11/10/is-esg-for-equity-investing-a-bubble-this-survey-suggests-it-could-be/?sh=5a61a5433840; James Mackintosh, *Sustainable Investing Bubbles Can Change the World—and Sink Your Portfolio*, WALL ST. J. (Jan. 25, 2022, 11:13 AM) (https://www.wsj.com/articles/sustainable-investing-bubbles-can-change-the-worldand-sink-your-portfolio-11643126999).

7 For instance, on SSRN, the number of papers containing the word "ESG" grew by 240% over the last three years (April 2020 versus April 2023).

8 *See, e.g.*, Allison Herren Lee, Comm'r, Sec. & Exch. Comm'n, Climate, ESG, and the Board of Directors: "You Cannot Direct the Wind, But You Can Adjust Your Sails," Keynote Address at the 2021 Society for Corporate Governance National Conference (June 28, 2021), *in* SEC. & EXCH. COMM'N: SPEECHES AND STATEMENTS, June 2021; Eur. Cent. Bank, Banking Supervision, Guide on Climate-Related and Environmental Risks: Supervisory Expectations Relating to Risk Management and Disclosure, at 3-5 (Nov. 2020). On broader macroeconomic projects, *see* G.A. Res. 70/1, Transforming Our World: The 2030 Agenda for Sustainable Development (Sept. 25, 2015); Paris Agreement to the United Nations Framework Convention on Climate Change, Dec. 12, 2015, T.I.A.S. No. 16-1104; *Commission Proposal Stepping Up Europe's 2030 Climate Ambition*, at 3-7, COM (2020) 562 final (Sept. 17, 2020); BASEL COMM. ON BANKING SUPERVISION, BANK FOR INT'L SETTLEMENTS, CLIMATE-RELATED RISK DRIVERS AND THEIR TRANSMISSION CHANNELS (2021).

9 Dottie Schindlinger, *Corporate Boards Are Suffering from ESG Burnout. Here Are 4 Ways They Can Fix It*, FORTUNE (Oct. 29, 2021, 9:00 AM), https://fortune.com/2021/10/29/corporate-boards-esg-burnout-diligent-institute/.

movement, the opioid crisis, and the war in Ukraine have all contributed to the call for acknowledgement and action by corporate leaders.

Yet a number of unanswered questions might indicate the need for further development in this area. For example, little consensus exists on how to define and measure progress on ESG.[10] Furthermore, there still seems to be no answer to the crucial question of whether the pursuit of ESG goals actually has a positive impact on corporate performance.[11] As long as these fundamental questions remain subject to debate, it is unclear exactly what is expected from "corporate citizens."

The momentum gained by the promotion of ESG objectives also raises the question of whether this concern for reshaping policy goals and values may conceal a deeper issue: While corporations are expected to embrace the values of societies they interact with, it is worth considering whether the demand for ESG goals signals a deeper request that corporations act responsibly. I suggest that ESG values relate to a more basic demand for integrity.[12] The magnitude of negative externalities generated by corporations may actually have led to an amplified desire to see those responsible held accountable for misconduct and actions that harm society. In fact, discussions around corporate governance have often united corporate purpose and liability for breach of fiduciary duties as interconnected topics.[13]

The dualism between corporate purpose and fiduciary duties becomes particularly relevant in those circumstances where corporations engage in actions exclusively aimed at pursuing shareholder value maximization without addressing their broader social impact, or "externalities." Recent examples have shown the pervasively destructive effects on employees, communities, and the

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10 Paul Brest & Colleen Honigsberg, *Measuring Corporate Virtue and Vice: Making ESG Metrics Trustworthy*, *in* FRONTIERS IN SOCIAL INNOVATION: THE ESSENTIAL HANDBOOK FOR CREATING, DEPLOYING, AND SUSTAINING CREATIVE SOLUTIONS TO SYSTEMIC PROBLEMS 79, 80, 82 (Neil Malhotra ed., 2022).

11 Larcker, et al., *supra* note 5, at 2; *see also* Cornell & Damodaran, *supra* note 5, at 89-90.

12 For an exploration of integrity and its role in the business world, see Michael C. Jensen, *Integrity: Without It, Nothing Works*, ROTMAN MAG.: THE MAG. OF THE ROTMAN SCH. OF MGMT., Fall 2009, at 16, 16-20, https://ssrn.com/abstract=1511274.

13 Concern for corporate accountability has formed the background of corporate governance dialogues for several decades. *See, e.g.*, AM. L. INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 1-26 (1981).

environment brought about by such conduct.[14] Consequently, there have been calls for a fundamental rethinking of the very role of boards of directors in light of the increased litigation risk, already manifest in a number of different contexts.[15]

Moreover, white collar criminal law has also been engaged in the attempt to foster responsible corporate behavior through more active involvement of decision-makers and improved compliance functions.[16] Nevertheless, corporate criminal enforcement remains limited to instances of conduct that qualify as criminal, leaving out a substantial portion of cases where enforcement relies on other areas of the law. Thus, fostering responsible corporate behavior requires a broad set of interventions across areas that relate to corporate culture.

II. THE LIMITATIONS IN CORPORATE LAW

Building on the idea that ESG needs are driven by a societal request for integrity, in this section I will explore the tools that corporate law offers to enforce potential ESG-related duties owed by boards of directors.

Delaware law and its jurisprudence have dictated the evolution of fiduciary duties in U.S. corporate law. A natural consequence of Section 141(a) of Delaware General Corporation Law ("DGCL"), which entrusts the board of directors with managing the business and affairs of the corporation,[17] is that fiduciaries owe to the corporation and its shareholders two distinct duties: the duty of care and the duty of loyalty. Under the duty of care, directors are required to make decisions based on all material information reasonably available. Courts apply a standard of review known as the "business judgment rule," which will shield the board from liability as long as the decision was

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14 *See infra* Sections 4 and 6.1 for more detail. On the opioid crisis, the most emblematic document discussing corporate governance practices in Purdue Pharma is the expert report of Professor John Coffee. *See* Expert Report of Professor John C. Coffee, Jr., *In re* Purdue Pharma L.P., No. 107102 (Utah Div. of Consumer Prot. July 12, 2019). Professor Coffee provides an account of what he labels as the "dysfunctional corporate governance" in place at Purdue Pharma and discusses what remedies are available in corporate law for breaches of fiduciary duties. *Id.* at 39. For an account of sexual harassment scandals in the corporate world, see Daniel Hemel & Dorothy S. Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583 (2018).

15 *See infra* Section 6 for more detail.

16 *See, e.g.*, Memorandum from Lisa O. Monaco, Deputy Att'y Gen., U.S. Dep't of Just., to All Component Heads and United States Attorneys (Sept. 15, 2022), https://www.justice.gov/opa/speech/file/1535301/download.

17 DEL. CODE ANN. tit. 8, § 141(a) (2023).

informed and made in good faith.[18] In addition, corporations may adopt a provision in their certificate of incorporation in accordance with DGCL Section 102(b)(7), which permits exculpation of directors and certain officers for violations of the duty of care committed in good faith.[19] The likely intersection point between the duty of care and ESG is the area of directors' competencies, since investors will expect directors to have adequate expertise to handle ESG issues relevant to the corporation.[20] Yet, given the very high bar for duty of care liability and the prevalence of exculpatory charter provisions in Delaware corporations, it is highly unlikely that expectations driven by the new ESG considerations will create a serious risk of liability for directors under the duty of care.

Under the duty of loyalty, directors must act in good faith, pursue the best interest of the corporation, and maintain an oversight system they believe is adequate. Commentators, including former Delaware Supreme Court Chief Justice Leo Strine, have suggested that corporations should consider ESG as part of the broader field of compliance.[21] As a consequence, the duty of loyalty under *Caremark*[22] and *Marchand*[23] would already incorporate implementation of ESG-related requirements, due to an overlap between ESG and legal/regulatory duties. While the classification of ESG as compliance offers the benefit of decreasing pressure on the board of directors to find new ways to implement stakeholder concerns, it also carries the risk of tying ESG to the duty of loyalty and the remedies associated with its breach. As Strine has noted,

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18 Thus, in order to prove that there was a breach of the duty of care, a plaintiff would have to show that the board's decision was taken with gross negligence or with conscious disregard of the corporation's best interests. *See* Stone *ex rel.* AmSouth Bancorporation v. Ritter, 911 A.2d 362, 369-70 (Del. 2006).

19 DEL. CODE ANN. tit. 8, § 102(b)(7) (2023). Under DGCL § 102(b)(7), officers may not be exculpated from liability in a derivative suit.

20 *See* TENSIE WHELAN, U.S. CORPORATE BOARDS SUFFER FROM INADEQUATE EXPERTISE IN FINANCIALLY MATERIAL ESG MATTERS (2021), https://ssrn.com/abstract=3758584.

21 Leo E. Strine, Jr. et al., Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 IOWA L. REV. 1885, 1888 (2021) ("We agree that a greater focus on sustainability and respect for stakeholders is socially useful, but instead of adding a new component to the traditional fiduciary duties of loyalty and care, we situate EESG within the established legal regime and propose a way for boards to address the demands of EESG and compliance in an integrated, efficient, and effective way.").

22 *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996).

23 Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019) ("Under *Caremark* and this Court's opinion in *Stone v. Ritter*, directors have a duty 'to exercise oversight' and to monitor the corporation's operational viability, legal compliance, and financial performance." (footnotes omitted) (quoting *Stone v. Ritter*, 911 A.2d 362, 364)).

"liability under *Caremark* is hard to prove"[24] because it requires that the plaintiff show the complete failure of good faith efforts to implement or update internal information and reporting systems.[25] Nevertheless, more recently, the Supreme Court of Delaware has taken a stance that appears to increase scrutiny on compliance systems, concluding that "compliance issue[s] [are] intrinsically critical to the company's business operation[s] . . . ."[26] In light of these developments, a crucial question is whether ESG goals should be considered "mission critical" issues to the company's operations, since the answer may guide the outcome of a *Caremark* claim for alleged failures relating to ESG practices.

Moreover, procedurally, fiduciary duties are enforced through derivative suits, *i.e.*, suits brought by shareholders on behalf of the corporation. Derivative suits require shareholders to first demand that directors themselves file the lawsuit, unless such a demand is excused because it would be "futile."[27] Even where demand is excused, in most cases, corporations set up a special litigation committee of independent directors to objectively investigate the merits of the claim.[28] As long as the committee is independent and acts in good faith, if the outcome of the internal investigation is a motion to dismiss by the committee on behalf of the corporation, courts will apply the business judgment rule and grant the motion.[29] Thus, there are significant procedural barriers to bringing a successful derivative suit against the directors.

Trends observed in derivative suits also merit consideration.[30] Over the last thirty years, several empirical studies have shed light on the most likely outcome

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24 Strine et al., *supra* note 21, at 1896.

25 Therefore, the standard is bad faith. *See* Desimone v. Barrows, 924 A.2d 908, 935 (Del. Ch. 2007) (defining bad faith to mean "the state of mind traditionally used to define the mindset of a disloyal director").

26 Marchand, 212 A.3d at 822.

27 United Food & Com. Workers Union v. Zuckerberg, 262 A.3d 1034, 1047 (Del. 2021).

28 *See, e.g.*, Zapata Corp. v. Maldonado, 430 A.2d 779, 786-89 (Del. 1981).

29 *Id.* at 787.

30 *See* Roberta Romano, *The Shareholder Suit: Litigation Without Foundation?*, 7 J. L. ECON. & ORG. 55 (1991).

of the limited number of derivative suits that survive motions to dismiss.[31] Most recently, Krishnan et al. have found that a significant number of derivative suits either settle or are dismissed, and only small percentage results in outcomes in favor of the plaintiff.[32]

What does all this tell us about potential ESG-related liability in the context of corporate law? The most plausible conclusion is that while scrutiny on the board's role in compliance might have increased after *Marchand*, it is unlikely that the demand for accountability of directors and officers will be met in courtrooms through the channel of derivative suits. While most of the current discussions revolve around the classification of ESG goals, violations related to the pursuit of ESG objectives by the corporation might be difficult to enforce through the present liability standards in Delaware.

III. PRACTICES IN BANKRUPTCY LAW

Further complexity in the area of director and officer accountability is added by the circumstance that bankruptcy proceedings often become litigation grounds for derivative suits.[33] Thus, the practices developed in bankruptcy law are an additional element to consider in the evolution of corporate governance. The unique nature of bankruptcy policy objectives—aiming to provide the debtor with a "fresh start"—has led to the development of bankruptcy-specific procedural tools. Nevertheless, due to its distinctive characteristics, bankruptcy law also created opportunities for gaming. To this end, tools such as

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31 *See, e.g.*, Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2045-46 (2019) ("Examining the *Caremark* doctrine on oversight responsibility, however, reveals that in practice the potential for accountability through fiduciary law has been narrowly circumscribed. With limited exception, the small handful of oversight cases decided by Delaware courts that have survived motions to dismiss involved pleadings of either a complete lack of board-level oversight or egregious disobedience such as allegations that a corporation was engaged in pervasive wrongdoing or directors were complicit in fraudulent business models or practices. Furthermore, in case law to date, Delaware courts have prioritized giving directors broad latitude to take business risk by drawing a line at legal risk, despite the possibility that both types of activity could create social value or harm depending on the circumstances.").

32 *See generally* C.N.V. Krishnan et al., *How Do Legal Standards Matter? An Empirical Study of Special Litigation Committees*, 60 J. CORP. FIN. 101543 (2020) (discussing outcomes in cases involving special litigation committees).

33 *See* Russell C. Silberglied, *Litigating Fiduciary Duty Claims in Bankruptcy Court and Beyond: Theory and Practical Considerations in an Evolving Environment*, 10 J. BUS. & TECH. L. 181, 181 (2015).

"channeling injunctions" and "third-party (non-debtor) releases" have played a significant role in Chapter 11 cases.[34]

A "channeling injunction" serves the purpose of redirecting claims brought against the debtor to a trust established under the bankruptcy plan. Originally developed to address the high volume of asbestos lawsuits in the context of a bankruptcy procedure,[35] channeling injunctions for debtors facing asbestos-related claims were formally recognized by Congress in Section 524(g) of the Bankruptcy Code in 1994.[36] Section 524(g) foresees the creation of a litigation trust to which any future asbestos-related tort claims are "channeled," thus prohibiting any claim of that type from being brought in state court or outside of the trust mechanism.[37] While Section 524(g) was limited to asbestos cases, under the general equitable power contained in Section 105(a),[38] courts have extended the application of this mechanism to non-asbestos cases, giving rise to third-party releases.[39] These practices constitute safe harbors for potentially liable parties, who benefit from beneficial treatment in exchange for contributions made to the debtor in bankruptcy.[40]

While the jurisprudence is not unanimous as to whether third-party releases should be allowed,[41] courts sometimes approve the releases in order to achieve the primary objective of maximizing the estate for the benefit of creditors. The

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34 *See* Gary Svirsky et al., *A Field Guide to Channeling Injunctions and Litigation Trusts*, N.Y. L. J. (July 13, 2018, 3:40 PM), https://www.law.com/newyorklawjournal/2018/07/13/channelling-injunctions-and-litigation-trusts-a-field-guide/ ("A court-approved channeling injunction can direct—or channel—tort claims to a litigation trust funded by participating parties. Claimants must then look exclusively to the trust assets to satisfy their claims, which can provide them with an efficient claims-evaluation process that typically does not require the level of proof they would need to satisfy in court. At the same time, the channeling injunction and trust insulate debtors, certain non-debtor defendants, and other participants from known current and future claims."); Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L. J. 1154, 1158-60 (2022).

35 *In re* Johns-Manville Corp., 68 B.R. 618, 627 (Bankr. S.D.N.Y. 1986).

36 Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447, 483 (2022).

37 11 U.S.C. § 524(g).

38 11 U.S.C. § 105(a).

39 *See generally* Simon, *supra* note 34, at 1171-74 (explaining the progression of nondebtor releases and channeling injunctions from asbestos litigation to other mass-tort litigation).

40 Because of the contributions that these third-parties make, they are also known as "gifters." *Id.*; Michael Carnevale, *Comment: Is Gifting Dead in Chapter 11 Reorganizations? Examining Absolute Priority in the Wake of the Second Circuit's No-Gift Rule in* In re DBSD, 15 U. PA. J. BUS. L. 225, 225 (2013).

41 *See e.g.*, *In re* FirstEnergy Sol. Corp., 606 B.R. 720, 735-36 (Bankr. N.D. Ohio 2019) (discussing the use of third-party releases to satisfy creditors but ultimately rejecting the use of a third-party release in the case at bar).

current split among U.S. circuit courts on the admissibility of non-consensual[42] "global settlements" is fueled by a heated debate surrounding the ethical aspects of such solutions, since these "allow nondebtors to absorb benefits that Congress designed for debtors only."[43] These releases are particularly relevant to the question of accountability because they are often specifically designed to release corporate actors from all liability stemming from their duties and operations. Those who benefit the most are clearly the individuals who were involved in the management of the corporation and who may otherwise face substantial financial liability for alleged wrongdoing in their corporate roles.[44]

The analysis of Professor John Coffee in his expert report in the Purdue Pharma bankruptcy proceeding offers insight into the potential significance of

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42 *Id.* at 733; *In re* Purdue Pharma, L.P., 635 B.R. 26, 67 (S.D.N.Y. 2021) ("[T]hird-party releases . . . bind the objecting parties as well as the parties who consented.").

43 Simon, *supra* note 34, at 1158, 1162. Bankruptcy Judge Robert Drain, who approved the 11th version of the Chapter 11 plan in the bankruptcy proceeding of Purdue Pharma and affiliates, referred to the outcome as "a bitter result. B-I-T-T-E-R." *In re Purdue Pharma, L.P.*, 635 B.R. at 73. Judge Drain further added, "It is incredibly frustrating that the law recognizes, albeit with some exceptions, although fairly narrow ones, the enforceability of spendthrift trusts. It is incredibly frustrating that people can send their money offshore in a way that might frustrate U.S. law. It is frustrating, although a long-established principle of U.S. law, that it is so difficult to hold board members and controlling shareholders liable for their corporation's conduct. It is incredibly frustrating that the vast size of the claims against the Debtors and the vast number of claimants creates the need for this plan's intricate settlements. But those things are all facts that anyone who is a fiduciary for the creditor body would have to recognize, and that I recognize." *Id; see also* Brian Mann, *The Sacklers, Who Made Billions From OxyContin, Win Immunity From Opioid Lawsuits*, NPR (Sept. 1, 2021, 7:33 PM), https://www.npr.org/2021/09/01/1031053251/sackler-family-immunity-purdue-pharma-oxcyontin-opioid-epidemic. In addition, extensive media coverage has been gained by the "Nondebtor Release Prohibition Act of 2021," a legislative proposal presented by a group of Democratic members of Congress, headed by Senator Elizabeth Ann Warren, S. 2497, 117th Cong. (2021). The bill is specifically designed to prohibit the non-consensual third-party releases and limit channeling injunctions under Section 105 of the Bankruptcy Code. *Id.*

44 *In re Purdue Pharma, L.P.*, 635 B.R. at 59 ("Purdue's bankruptcy was thus a critical part of a strategy to secure for the Sacklers a release from any liability for past and even future opioid-related litigation without having to pursue personal bankruptcy.").

these practices:[45] standing to enforce fiduciary duties shifts from the shareholders to creditors when a company becomes insolvent. This effect is even more relevant in bankruptcy proceedings involving closely held corporations, where there is often an overlap between ownership and control.[46] In closely held corporations, insolvency status would increase the chances of enforcement of owner-managers' fiduciary duties, since it would give creditors standing to bring suit.[47] In the absence of this shift in the parties with enforcement power, it is impossible to imagine that owner-managers would seek to enforce breaches of fiduciary duty against themselves.

Notwithstanding the addition of creditors to the pool of potential plaintiffs in insolvent companies, the outcome of the appeal against the Purdue Pharma plan has demonstrated the difficulty of overturning third-party releases. While the District Court decision by Judge McMahon vacated the plan's confirmation, on May 30, 2023, the United States Court of Appeals for the Second Circuit issued an order reversing the District Court vacatur.[48] Yet, the ruling by Judge McMahon is noteworthy in a number of respects, as it traces the history of the company, underlining the degraded corporate culture referenced by Professor

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45 Expert Report of Professor John C. Coffee, *supra* note 14, at 33 ("Under standard corporate law principles, the fiduciary duties of the directors run to the shareholders, except when the corporation becomes insolvent. At this point of insolvency, the directors' duty shifts from the shareholders to the creditors, and the directors must serve as trustees on their behalf. Under Delaware law, the moment of this shift occurs when the corporation actually becomes insolvent (not when it later files for bankruptcy). Thus, if Purdue is already insolvent (in the sense that its liabilities exceed its assets or it is unable to meet its liabilities as they become due), the directors' duties run to its creditors (including opioid victims)." (footnotes omitted)).

46 Henry Hansmann, *Ownership of the Firm*, 4 J. L. ECON. & ORG. 267, 269 (1988). *See, e.g.*, *In re Purdue Pharma, L.P.*, 635 B.R. at 57-58 ("The testimony that [Judge Drain] heard from the Sacklers tended to show, that as a closely held company Purdue was run differently than a public company and that its Board and shareholders took a major role in corporate decision-making, including Purdue's practices regarding its opioid products that was more akin to the role of senior management.").

47 Expert Report of Professor John C. Coffee, *supra* note 14, at 33.

48 *Id.* at 37-38 ("[T]he Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or 'residual' powers on a court sitting in bankruptcy."); *In re Purdue Pharma L.P.*, No. 22-110-bk(L) (2d Cir. May 30, 2023).

Coffee, and sought intervention by the Second Circuit to resolve the substantive question of whether third-party releases can be granted.[49]

The above account illustrates how the possibility of obtaining immunity through bankruptcy filings and Chapter 11 plans creates a significant incentive for debtors and their related parties to seek this safe harbor.[50] By contrast, bankruptcy of the corporate debtor poses substantial risks to creditors (including tort victims) since their chances to recover on claims and to pursue legal action against responsible parties may decline drastically, depending on the provisions included in the Chapter 11 plan. With regard to ESG violations, a consequence of the practices developed in bankruptcy may signify that enforcement of ESG-related fiduciary duties will encounter additional obstacles when the corporation becomes insolvent.

IV. California Board Diversity Laws

California's board diversity laws, perhaps the most ambitious and publicly debated ESG-related legislative initiatives, provide yet another example of the difficulties encountered in the area of ESG or diversity legislation. California's 2018 Senate Bill No. 826 ("SB 826"), which added Sections 301.3 and 2115.5 to the California Corporations Code, required the board of directors of corporations incorporated or headquartered in California to comply with minimum quotas of seats to be held by females.[51] More specifically, SB 826 required boards to appoint at least one female board member by the end of 2019, and either two or three, depending on whether the total number of board members was five or more, by the end of 2021.[52] The law also provided for

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49 Expert Report of Professor John C. Coffee, *supra* note 14, at 118 ("This decision leaves on the table a number of critically important issues that were briefed and argued on appeal – principal among them, whether the Section 10.7 Shareholder Release can or should be approved on the peculiar facts of this case, assuming all the other legal challenges to their validity were resolved in Debtors' favor.").

50 *In re* Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019) ("Unfortunately, in actual practice the parties . . . often seek to impose involuntary releases based solely on the contention that anybody who makes a contribution to the case has earned a third-party release. Almost every proposed Chapter 11 Plan that I receive includes proposed releases.").

51 S.B. 826, 2017-18 Leg., Reg. Sess. (Cal. 2018); CAL CORP. CODE § 301.3 (2021). The definition of "female" contained in SB 826 reads as follows: "'Female' means an individual who self-identifies her gender as a woman, without regard to the individual's designated sex at birth." S.B. 826, 2017-18 Leg., Reg. Sess. § 2(f)(1) (Cal. 2018).

52 S.B. 826, 2017-18 Leg., Reg. Sess. § 2(a)-(b)(3) (2018).

fines of $100,000 for the first violation, and $300,000 for each subsequent violation.[53]

The policy underlying SB 826 was set out in the law itself:

> More women directors serving on boards of directors of publicly held corporations will boost the California economy, improve opportunities for women in the workplace, and protect California taxpayers, shareholders, and retirees, including retired California state employees and teachers whose pensions are managed by CalPERS and CalSTRS. Yet studies predict that it will take 40 or 50 years to achieve gender parity, if something is not done proactively.[54]

Nevertheless, shortly after its enactment, SB 826 attracted criticism, principally on the basis of its alleged unconstitutionality.[55] Thus, while compliance with the new provision was just beginning, by August 2019 the first of a series of lawsuits challenging the law was filed.[56]

In 2020, the California legislature continued with its diversity objective by issuing Assembly Bill No. 979 ("AB 979"), which expanded the scope of SB 826 by requiring boards to have directors from underrepresented communities.[57] Following the same structure of SB 826, AB 979's two-year roll-out period required affected companies to significantly alter the composition of their boards or face sanctions identical to those for violation of SB 826.[58] Shortly after its adoption, AB 979 was also subject to a lawsuit challenging its constitutionality.

The complaint challenging the constitutionality of the original provision, SB 826, alleged that the "Women on Boards" law impaired shareholders' individual voting rights and violated the Fourteenth Amendment because it

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53 *Id.* § 2(e)(1)(B)-(C).

54 *Id.* § 1(a).

55 *See generally* Joseph A. Grundfest, *Mandating Gender Diversity in the Corporate Boardroom: The Inevitable Failure of California's SB 826* 1-12 (Rock Ctr. for Corp. Governance at Stan. Univ., Working Paper No. 232, 2019), https://ssrn.com/abstract=3248791.

56 *E.g.*, Crest v. Padilla, No. 19STCV27561, 2022 WL 1565613 (Cal. Super. Ct. May 13, 2022) (filing a Complaint for Declaratory and Injunctive relief in August 2019).

57 Assemb. B. 979, 2019-20 Leg., Reg. Sess. (Cal. 2020); CAL CORP. CODE § 301.4 (2022). The definition of "director from an underrepresented community" contained in AB 979 reads as follows: "'Director from an underrepresented community' means an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender." Assemb. B. 979, 2019-20 Leg., Reg. Sess. § 3(e)(1) (Cal. 2020).

58 Assemb. B. 979, 2019-20 Leg., Reg. Sess.§§ 3 (a)-(b)(3), (d)(B)-(C) (Cal. 2020).

constituted a sex-based classification.[59] The lawsuit was initially dismissed for lack of standing,[60] but the Ninth Circuit reversed in June 2021.[61] After protracted procedural litigation, on May 13, 2022, California Superior Court Judge Maureen Duffy-Lewis ruled in favor of the plaintiffs (*Crest I*), ruling SB 826 unconstitutional as a violation of the Equal Protection Clause of Article 1, Section 7 of the California Constitution.[62]

In *Crest I*, the Superior Court of California, County of Los Angeles, found that the design of the statute, which contained a "suspect classification," invoked strict scrutiny, with a resulting shift in the burden of proof to the government.[63] As a consequence, the government had to prove, "(1) a compelling state interest, (2) that S.B. 826 is necessary, and (3) that S.B. 826 is narrowly tailored. The strict scrutiny standard applies even if a law is claimed to be remedial."[64] The court held that the government failed to satisfy its burden.[65]

Six weeks prior to the *Crest I* decision, AB 979 had also been ruled unconstitutional (known as *Crest II*, although it was decided prior to *Crest I*).[66] As described in the opinion of *Crest II*, AB 979 raised similar issues. First, the court noted that "the groups selected for preference by the statute are not inclusive of all numeric minorities[,]"[67] suggesting that the statute had arbitrarily chosen the protected groups.[68] As in *Crest I*, this triggered the strict scrutiny standard. Second, the court underlined that "it is not enough for the state to broadly offer an intent to address general discrimination."[69] The state had failed to properly identify the "specific arena in which discrimination has occurred."[70]

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59 Complaint for Declaratory and Injunctive Relief at 5-6, Meland v. Padilla, 2020 WL 1911545 (E.D. Cal. Apr. 20, 2020) (No. 2:19-cv-02288).

60 Meland v. Padilla, No. 2:19-cv-02288, 2020 WL 1911545, at *13 (E.D. Cal. Apr. 20, 2020).

61 Meland v. Weber, 2 F.4th 838, 849 (9th Cir. 2021).

62 Crest v. Padilla, No. 19STCV27561, 2022 WL 1565613, at *23 (Cal. Super. Ct. May 13, 2022).

63 *Id.* at *7, *10.

64 *Id.* at *7.

65 *Id.* at *22-23.

66 *See* Crest v. Padilla, No. 20STCV37513, 2022 WL 1073294 (Cal. Super. Ct. Apr. 1, 2022).

67 *Id.* at *9 ("In a written inquiry, the court asked specifically why these groups were chosen. The court also asked why two different types of minorities (ethnic and sexual orientation/identity) were included while other types of minorities (such as religious minorities) were excluded. In their Reply (at footnote 7), the Secretary stated that these were the groups that had statistical discrepancies and no other group asked to be included.").

68 *Id.* ("In effect, the included groups were included simply because they asked to be. Excluded groups were excluded because they didn't show up." (footnote omitted)).

69 *Id.* at 11.

70 *Id.*

Third, the court questioned the data on which the statute was enacted: "Statistical evidence is 'significant' but by itself insufficient to support a finding of discrimination."[71]

In conclusion, the initial assessment of the legal basis of legislative attempts to create more diverse boards by using quota systems has proven utterly challenging due to the high bar required for legislative formulas of this kind. Yet, limiting the evaluation of these acts' impact solely to a legal standpoint would carry the risk of neglecting their full potential. In the years since their passage, these laws have contributed to increases in board diversity. In fact, while the appeals by the California Secretary of State are pending,[72] diversity implemented thus far is unlikely to be reversed in light of its reputational value.

V. ESG LITIGATION

In recent years, multiple attempts to enforce corporate accountability in ESG-related areas have given rise to what has been labeled "ESG litigation." ESG litigation comprises a broad range of lawsuits generally pertaining to the accuracy of companies' disclosure documents. While the growing pressure to implement sustainability and diversity objectives has incentivized businesses to engage in virtue signaling activities,[73] the Securities and Exchange Commission ("SEC") and investors have closely scrutinized ESG-related disclosures. In light of the legal risk stemming from such activities, the legal community has attempted to caution businesses not to set overly far-reaching objectives.[74] Furthermore, a review of ESG-related litigation suggests that a company's

71 *Id.* at 13.

72 Teresa L. Johnson et al., *Double Trouble: California Set to Challenge Two Decisions Rejecting Diversification of Corporate Boards*, ARNOLD & PORTER KAYE SCHOLER LLP (Aug. 5, 2022), https://www.arnoldporter.com/en/perspectives/advisories/2022/08/california-set-to-challenge-two-decisions?utm_source=Mondaq&utm_medium=syndication&utm_campaign=LinkedIn-integration.

73 *See* Lorianne D. Mitchell & Wesley D. Ramey, *Look How Green I Am! An Individual-Level Explanation for Greenwashing*, 12 J. APPLIED BUS. & ECON. 40 (2011). The authors refer to the concept of "competitive altruism" which they describe as "a social phenomenon defined as 'the process through which individuals attempt to outcompete each other in terms of generosity[.]'" *Id.* at 42 (quoting Charlie L. Hardy & Mark Van Vugt, *Nice Guys Finish First: The Competitive Altruism Hypothesis*, 32 PERSONALITY & SOC. PSYCH. BULL., 1402, 1403 (2006)).

74 Michael Callahan et al., *The General Counsel View of ESG Risk*, STAN. CLOSER LOOK SERIES, Sept. 14, 2021, at 3 ("[M]any General Counsel would recommend a policy of restricting their company from engaging in causes not directly related to the company's strategic and financial mission.").

public disclosure of ESG goals prompts more intense scrutiny of its commitment to such goals, which increases ESG litigation risk. Additionally, shareholders will continue to be concerned with the company's profitability aside from the pursuit of ESG goals.[75]

A. "E" or Climate Litigation

"E" or climate litigation has primarily seen the emergence of federal securities class actions for allegedly misleading statements about the company's sustainable activities, compliance with environmental safety regulations, and, in particular, carbon offsets.[76] "Greenwashing"[77] lawsuits have targeted not only companies responsible for high levels of greenhouse gas emissions, such as companies operating in the oil and gas industry, but also "sustainable" or "green" companies.

Following the 2017-2018 wildfires in Southern California, a securities class action was brought against Edison International,[78] the "public utility [company] that develops and operates infrastructure for the production and distribution of energy (e.g., power plants and electric lines), and supplies electricity to

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75 *See, e.g.*, *In re* Tesla Motors, Inc. S'holder Litig., C.A. No. 12711-VCS, 2022 WL 1237185 (Del. Ch. 2022), which demonstrates the importance that shareholder primacy still holds in the current environment. While the case is a conflict of interest case that involved obtaining shareholder approval for the acquisition of a solar energy company, SolarCity Corporation, it also constitutes an instance where shareholders brought a lawsuit against the board regardless of the fact that the challenged acquisition of SolarCity would be aligned with the company's ultimate goal of "accelerat[ing] the world's transition to sustainable energy" by helping to "expedite the move from a mine-and-burn hydrocarbon economy towards a solar electric economy . . . ." *Id.* at *1 (quoting Transcript of Record at 86:18-20, *Tesla Motors*, 2022 WL 1237185). The Delaware Chancery Court recognized that, "[w]hether the Acquisition played a large or small part in Tesla's impressive growth is not clear, but there can be no doubt that the combination with SolarCity has allowed Tesla to become what it has for years told the market and its stockholders it strives to be—an agent of change . . . ." *Tesla Motors*, 2022 WL 1237185, at *47.

76 *See* Chris Greenberg, *Carbon Offsets Are a Scam*, GREENPEACE (Nov. 10, 2021), https://www.greenpeace.org/international/story/50689/carbon-offsets-net-zero-greenwashing-scam/; *See generally* KOREY SILVERMAN-ROATI, SABIN CTR. FOR CLIMATE CHANGE L., U.S. CLIMATE LITIGATION IN THE AGE OF TRUMP: FULL TERM (2021) (offering an account of climate-focused litigation brought before a judicial body during the Trump administration and highlighting how, despite widespread deregulatory efforts, hundreds of plaintiffs attempted to obtain enforcement by turning to the judiciary).

77 *Greenwashing*, OXFORD ENGLISH DICTIONARY (3d ed. 2011) (defining "greenwashing" as "[t]he creation or propagation of an unfounded or misleading environmentalist image.").

78 *See* Bill Gabbert, *Power Company to Pay $360 Million to Settle Wildfire Lawsuits*, WILDFIRE TODAY (Nov. 14, 2019), https://wildfiretoday.com/tag/woolsey-fire/ (noting that the lawsuit specifically referred to two fires known as the Thomas fire and the Woolsey fire).

residential, commercial, industrial, and other customers."[79] The complaint alleged that Edison International had made materially false and misleading statements and had failed to disclose material adverse facts concerning the company's compliance with safety requirements for the mitigation of wildfires in California.[80] The complaint was dismissed in 2021 by the Central District Court of California.[81] In 2019, a similar lawsuit was brought against PG&E Corporation in connection with a series of events known as the Northern California Fires and the Camp Fire.[82] According to the complaint, multiple PG&E registration statements contained several misleading statements regarding the company's strategies to prevent and address "the risks of climate change, including 'wildfire risk,'"[83] as well as the company's compliance with "robust regulatory requirements . . . 'relating to the protection of the environment and the safety and health of the Utility's personnel and the public[.]'"[84] While the lawsuit is still pending, PG&E's Chapter 11 plan of reorganization was confirmed in June 2020.

B. "S" or Diversity Lawsuits

The most prominent cases in the ESG litigation realm belong to the "diversity litigation" subcategory. In July 2020, the law firm Bottini & Bottini initiated a number of lawsuits targeting the lack of diversity on boards and allegedly misleading statements in public filings with the SEC.

A suit against Oracle was preempted by a labor law action initiated by the Department of Labor for alleged discriminatory pay practices toward minority

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79 Barnes v. Edison Int'l, No. CV 18-09690 CBM, 2021 WL 2325060, at *2 (C.D. Cal. Feb. 22, 2019).

80 *Id.* at *4-5.

81 *Id.* at *12-13.

82 Complaint for Violations of the Securities Act of 1933 at 1-2, York County v. Rambo, 2019 WL 917281 (N.D. Cal. Feb. 22, 2019) (No. 3:19-cv-00994-RS) ("[T]he Northern California Fires [] ravaged at least 245,000 acres of land and killed 44 people. At the time, the fires were the most destructive in California history and were responsible for over $13 billion in damages. . . . [T]he Camp Fire [] ignited in November 2018 in Butte County, California. This catastrophic event claimed the lives of at least 86 people and caused an estimated $16.5 billion in damages. The Camp Fire was reportedly the world's costliest natural disaster in 2018.").

83 *Id.* at 13.

84 *Id.* at 16.

employees.[85] While the lawsuit brought by the Department of Labor was terminated after an administrative law judge recommended dismissal of the case,[86] the allegations made in the claim triggered a federal claim for violation of Section 14 of the Securities and Exchange Act of 1934. The plaintiff's complaint referred to Oracle as "one of the oldest and most egregious 'Old Boy's Club' in Silicon Valley."[87] The lawsuit was dismissed by the District Court for the Northern District of California on the grounds that the plaintiff's allegations were not sufficiently particularized to determine whether a violation had occurred.[88]

A lawsuit against Facebook originated from the appointment and subsequent resignation of board member Kenneth Chenault, as well as from the company's alleged inability to monitor hate speech on the platform.[89] Highlighting disagreements between Facebook's CEO, Mark Zuckerberg, and Mr. Chenault, the plaintiff's complaint underlined Chenault's lack of stature on the board: "At Facebook, apparently Zuckerberg wants Blacks to be seen but not heard."[90] The allegation of false statements specifically referred to the divergence between the importance Facebook claimed to attach to diversity

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85 Complaint at 1, OFCCP v. Oracle Am., Inc., R00192699 (Dep't of Labor Jan, 17, 2017) ("[The] Office of Federal Contract Compliance Programs, United States Department of Labor ("OFCCP") brings this action against [] Oracle America, Inc. [] to redress violations stemming from Oracle's systemic compensation discrimination against women and Asians and African Americans in three lines of business (including 80 job titles) at its headquarters in Redwood Shores, California. Specifically, OFCCP found gross disparities in pay even after controlling for job title, full-time status, exempt status, global career level, job specialty, estimated prior work experience, and company tenure.").

86 *In re* OFCCP v. Oracle Am., Inc., 2017-OFC-00006, ALJ's Recommended Decision and Order (Dep't of Labor Sept. 22, 2020).

87 Verified Shareholder Derivative Complaint & Demand for Jury Trial at 5, Klein v. Ellison, No. 3:20-cv-04439 (N.D. Cal. July 2, 2020) ("A sign advising applicants 'Blacks Need Not Apply' might as well hang at the entrance to the Company's headquarters at 500 Oracle Parkway in Redwood Shores, California.").

88 Klein v. Ellison, No. 3:20-cv-04439, 2021 WL 2075591, at *4 (N.D. Cal. May 24, 2021) ("Plaintiffs have not alleged particularized facts that support an inference that the 2019 Proxy's representation that Oracle 'actively seek[s] women and minority candidates from the pool from which director candidates are chosen' was false or misleading. First, that 'no Black individuals currently serve on the Board' does not support an inference of the statement's falsity. Second, the complaint's allegation 'that the Board has never in good faith actively sought minority candidates' is a conclusion unsupported by particularized facts." (citations omitted)).

89 Verified Shareholder Derivative Complaint & Demand for Jury Trial at 3, Ocegueda v. Zuckerberg, No. 3:20-cv-04444-LB (N.D. Cal. July 2, 2020).

90 *Id.*

and the lack of implementation of its goals.[91] In March 2021, the case was dismissed by the Northern District of California court principally due to the failure to establish loss causation.[92]

A lawsuit involving Qualcomm mirrored the Oracle and Facebook complaints and targeted the lack of diversity on the board and in senior roles, as well as allegedly false allegations about the company's commitment to diversity.[93] The dismissal order by the District Court of Delaware stated that:

> The fact that no minority candidate has been elected to the Board in the last six years does not necessarily mean that the Governance Committee did not include or instruct its search firms to include 'racially/ethnically diverse candidates' in its pool of candidates. It could simply mean that those candidates did not advance past the larger candidate pool.[94]

C. "G" or Compliance Lawsuits

Analyzing the evolution of the last component of ESG poses unique challenges since some scholars argue that governance should not be combined with "E" and "S" for purposes of measuring ESG metrics.[95] Larcker and Tayan opine that the "G" element, *i.e.*, governance quality, should be promoted independently from the other objectives since it is a "universal [need] among organizations."[96] However, reconciling the inclusion of "G" within ESG may

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91 *Id.* at 5 ("In 2016, . . . Zuckerberg wrote, 'We care deeply about diversity. That's easy to say when it means standing up for ideas you agree with. It's a lot harder when it means standing up for the rights of people with different viewpoints to say what they care about. That's even more important.' But since these words were uttered, Zuckerberg and Facebook have failed to achieve the diversity they claim to prize."). *Compare supra* text accompanying note 87 (referring to Oracle as one of the oldest and most egregious 'Old Boy's Club' remaining in Silicon Valley), *with* Verified Shareholder Derivative Complaint & Demand for Jury Trial, *supra* note 89, at 5-6 ("In short, Facebook remains one of the oldest and most egregious 'Old Boy's Club' in Silicon Valley. A sign advising applicants 'Blacks Need Not Apply' might as well hang at the entrance to the Company's headquarters at 1 Hacker Way, Menlo Park, California."). Evidently, the Facebook complaint appears to use the same formula as the Oracle complaint.

92 Ocegueda *ex rel.* Facebook, Inc. v. Zuckerberg, 526 F. Supp. 3d 637, 641 (N.D. Cal. 2021).

93 *See* Kiger *ex rel.* Qualcomm Inc. v. Mollenkopf, No. 21-409-RGA, 2021 WL 5299581, at *2-3 (D. Del. Nov. 15, 2021).

94 *Id.* at *3.

95 David F. Larcker & Brian Tayan, *The Case for Taking the 'G' Out of ESG*, WALL ST. J. (April 28, 2022, 11:00 AM), https://www.wsj.com/articles/esg-the-case-for-taking-out-the-g-11651004068.

96 *Id.*

require a shift from the classical view of governance (*i.e.*, "a system of checks and balances to ensure that managers make decisions in the interest of the corporation")[97] to a compliance-centered perspective. This expands the scope of "G" to include businesses' adherence to new rules and adaptation to emerging social and market demands. This redefinition offers the advantage of drawing attention to "compliance litigation" and reputational risk.

In light of the evolving regulatory framework, compliance lawsuits are likely to represent the next phase of the evolving ESG litigation environment. For example, geopolitical tensions will require that businesses respect increasingly strict integrity standards.[98] Nevertheless, monitoring in this area proves particularly challenging due to the complexity of its various components, as well as the difficulty of identifying and resolving problems in multi-layered supply chains.[99] Moreover, while there are some instances that rise to prominence once they are addressed through regulatory intervention, regulatory approach carries the twofold risk of overgeneralization and limited reach. One example is the U.S. approach towards Chinese forced labor. The Uyghur Forced Labor Prevention Act ("UFLPA") establishes a rebuttable presumption that "any goods, wares, articles, and merchandise mined, produced, or manufactured wholly or in part" in the Xinjiang Uyghur Autonomous Region, absent "clear and convincing evidence," are produced with forced labor and, thus, their importation is prohibited.[100]

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97 *Id.*

98 Susan Ariel Aaronson & Ian Higham, *"Re-righting Business": John Ruggie and the Struggle to Develop International Human Rights Standards for Transnational Firms*, 35 HUM. RTS. Q. 333, 334 (2013) ("When businesses violate human rights, executives may create wounds that cannot easily be healed by apologies, time, or new management. As markets, technology, and politics change, many executives have struggled to ensure that their operations do not undermine the human rights of their stakeholders.").

99 *See, e.g.*, John G. Ruggie (Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises), *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, ¶ 38, U.N. Doc. A/HRC/14/27 (Apr. 9, 2010) ("[T]he Special Representative's corporate law project documents that none of the 40-plus jurisdictions studied specifically identify human rights-related risks as a factor in determining 'materiality', therefore few companies report them. This is despite the growing number of lawsuits against companies on human rights grounds, coupled with emerging evidence of significant costs triggered by human rights-based grievances . . . . Regulators should clarify that human rights impacts may be 'material' and indicate when they should be disclosed under current financial reporting requirements." (footnote omitted)).

100 Uyghur Forced Labor Prevention Act, Pub. L. No. 117-78, § 3(a), 135 Stat. 1525, 1529 (2021); *see also* H.R. 1155, 117th Cong. (2022) (addressing growing concerns related to "mass internment camps, [where detainees are] subjected . . . to forced labor, torture, political indoctrination, and other severe human rights abuses").

The UFLPA's design imposes a heavy burden on U.S. companies since obtaining the necessary documentation to rebut the presumption has proven to be very complicated, especially in light of the pushback from the Chinese government.[101] Thus, the UFLPA is likely to lead a number of U.S. companies to implement changes in their supply chains by opting for companies outside of Xinjiang.[102] While this would represent a first step towards addressing the concerns of labor violations perpetrated in Xinjiang, the UFLPA's limited reach to one region alone is not sufficient. The problem of labor violations would require a much more comprehensive action to ensure that companies are not simply shifting to other countries that continue to struggle with labor law enforcement.[103]

In the ESG-sensitive context, it is highly likely that supply-chain information will ultimately be considered part of the broader compliance function embedded in the governance structure. By adding instances of compliance such as the one described above to the area of ESG, the corporate world would not only benefit from the progress made in ESG-related disclosures to date but also positively contribute towards fostering responsible corporate behavior. As a consequence of such a development, corporate players would have to also account for an increased litigation risk stemming from more sophisticated compliance-related scrutiny.

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101 *See* Richard Vanderford, *Companies Face Compliance Challenges Under U.S. Forced-Labor Law Targeting China*, WALL ST. J. (July 4, 2022, 8:30 AM), https://www.wsj.com/articles/companies-face-compliance-challenges-under-u-s-forced-labor-law-targeting-china-11656937801.

102 *See* Yuka Hayashi, *Apparel Importers, Like Uniqlo, Tripped Up by U.S. Ban on Forced-Labor Goods From China*, WALL ST. J. (June 28, 2021, 1:36 PM), https://www.wsj.com/articles/bans-on-forced-labor-goods-from-china-fuels-disputes-with-importers-11624881600 (reporting accelerated enforcement of the U.S. ban on forced-labor goods from Xinjiang).

103 With regard to companies in the fashion industry violating Chinese labor laws outside of Xinjiang, see Jack Seale, *Untold: Inside the Shein Machine Review – The Brand That Knows What You're Going to Buy Before You Do*, GUARDIAN (Oct. 17, 2022, 2:00 PM), https://www.theguardian.com/tv-and-radio/2022/oct/17/untold-inside-the-shein-machine-review-the-brand-that-knows-what-youre-going-to-buy-before-you-do; Sangeeta Singh-Kurtz, *Shein Is Even Worse Than You Thought*, CUT (Oct. 17, 2022), https://www.thecut.com/2022/10/shein-is-treating-workers-even-worse-than-you-thought.html; Elizabeth Paton, *The New Laws Trying to Take the Anxiety Out of Shopping*, N.Y. TIMES (Oct. 3, 2022), https://www.nytimes.com/2022/09/30/fashion/fashion-laws-regulations.html; *see generally* HUM. RTS. WATCH, HUMAN RIGHTS IN SUPPLY CHAINS: A CALL FOR A BINDING GLOBAL STANDARD ON DUE DILIGENCE 4 (2016), https://www.hrw.org/sites/default/files/report_pdf/human_rights_in_supply_chains_brochure_lowres_final.pdf (urging "governments, employers, and trade unions . . . [to adopt] a new, international, legally binding standard that . . . require[s] business to conduct human rights due diligence in global supply chains").

D. Too Green to Be True

The growing role of companies' "ESG image" is also reflected in an increasingly common type of malpractice known as "greenwashing," which refers to an organization's act of disseminating misleading information to bolster its environmentally responsible public image. Companies that engage in greenwashing are often companies whose business model is built on the "green" concept, such as firms that position themselves as climate-friendly. Perhaps because of these companies' "green image," investors have engaged in heightened scrutiny of their public disclosures, at times exposing material omissions related to the environmental impacts of the business.

Oatly, for example, is one of the world's leading producers of oat-derived drinks, which have become a popular dairy-free substitute. The Swedish company underwent an initial public offering ("IPO") in May 2021, marketing itself as a "green" company.[104] Two months after the IPO, the investment firm Spruce Point Capital Management issued a report ("Sour on an Oat-Lier Investment") revealing misleading omissions about the company's impact on water consumption, its links to suppliers criticized for their role in deforestation, and transportation costs.[105] The issuance of the report prompted an immediate drop in the share price, as well as a lawsuit which is still pending.[106]

Over the years, greenwashing scandals have involved companies ranging from car manufacturers to coffee chains. Often, the drive to clean their images led companies to overplay their environmentally conscious practices and ambitions. While the reputational and financial impacts have varied, the cases noted above underline the increased scrutiny faced by ESG practices and disclosures. Yet, the legal responses appear rather slow and inadequate to meet the present demands for accountability.

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104 Oatly Grp. AB, Prospectus (Form 424B4) 15 (May 21, 2021) ("[W]e strive to serve as a proof point of sustainable investing and trigger a broader shift of capital deployment towards green initiatives and a greener future.").

105 SPRUCE POINT CAP. MGMT., SOUR ON AN OAT-LIER INVESTMENT (2021).

106 Complaint for Violations of the Federal Securities Laws at 2-3, *In re* Oatly Grp. AB Sec. Litig., No. 1:21-cv-06360-AKH (S.D.N.Y. July 26, 2021).

E. The "Corporate Optimism" Doctrine

The most common and central argument made by the courts in cases involving ESG-related statements derived from the concept of "puffery" and the line that case law has drawn between "aspirational" statements and false statements.[107] Courts have defined puffery as "vague statements of optimism like 'good,' 'well-regarded,' or other feel good monikers" that are not actionable because "professional investors, and most amateur investors as well, know how to devalue the optimism of corporate executives."[108] Moreover, courts have further noted that puffery encompasses "statements that are too general to cause a reasonable [person] to rely upon them, and thus cannot have misled a reasonable [person]. They are statements that lack the sort of definite positive projections that might require later correction."[109]

Thus, the "puffery" defense appears to be perhaps the biggest obstacle to the enforcement of statements about companies' ESG objectives. The Delaware District Court in the *Qualcomm* case concluded that "[s]tatements about a board's or a company's [diversity-related] goals are inactionable puffery, as multiple courts have held."[110] In the *Barnes v. Edison International* order of dismissal, the court referenced the concept of puffery and dismissed the case because "failures [to adequately maintain the electric power infrastructure] do not convert unactionable puffery into actionable statements."[111] While this defense seems to have lifted the weight off of companies engaging in the promotion of their image, should the puffery doctrine apply to the ESG context? The question can be more easily answered by retracing the origins of the defense and its deployment. In the United States, the puffery defense became more prominent in the 1990s, when courts began to draw a line between material misstatements as a matter of law from a "certain kind of rosy affirmation[s]."[112] The defense continued to be applicable to "exaggerated

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107 Ocegueda v. Zuckerberg, 526 F. Supp. 3d 637, 651 (N.D. Cal. 2021); *see generally* Robert N. Kravitz, *Room for Optimism: The "Puffery" Defense under the Federal Securities Laws (Part 1 of 2)*, 19 A.B.A. SEC. LITIG. J., Winter 2009; Robert N. Kravitz, *Room for Optimism: The "Puffery" Defense under the Federal Securities Laws (Part 2 of 2)*, 19 A.B.A. SEC. LITIG. J., Spring 2009.

108 Police Ret. Sys. v. Intuitive Surgical, Inc., 759 F.3d 1051, 1060 (9th Cir. 2014).

109 *In re* GE Sec. Litig., No. 19cv1013, 2020 WL 2306434, at *19 (S.D.N.Y. May 7, 2020) (quoting *In re* Vivendi, S.A. Sec. Litig., 838 F.3d 223, 245 (2d Cir. 2016)).

110 Kiger *ex rel.* Qualcomm Inc. v. Mollenkopf, No. 21-409-RGA, 2021 WL 5299581, at *3 (D. Del. Nov. 15, 2021).

111 Barnes v. Edison Int'l, No. CV 18-09690, 2021 WL 2325060, at *10 (C.D. Cal. Apr. 27, 2021).

112 Shaw v. Digit. Equip. Corp., 82 F.3d 1194, 1217 (1st Cir. 1996).

advertising, blustering, and boasting upon which no reasonable buyer would rely . . . ."[113]

Nevertheless, the present environment raises different concerns, and the "corporate optimism" doctrine provides another safe harbor for unethical corporate behavior. The defense fails to serve a beneficial purpose in the present environment since it provides a green light to potentially misleading statements in a socially-sensitive realm. The difficulties of establishing harmonized metrics providing for comparability in the area of ESG, coupled with the "puffery" defense, create an environment conducive to retarding the establishment of effective enforcement mechanisms in this context.

VI. ESG AND SECURITIES REGULATION

Long before ESG entered the ordinary vocabulary of corporate governance, some scholars advocated abolishing the separation between federal securities regulation and state corporate law.[114] Since the global financial crisis, efforts have been made to use securities regulation to address the negative impact that business has on employees, communities, and the environment. While securities law already provides room to address instances where publicly traded companies make misleading disclosures or fail to disclose material information,[115] recent initiatives are also emerging to address demands to promote ESG goals in the boardroom.

Over the past decade, the phenomenon of proxy proposals relating to issues such as climate change and social justice has continued to grow. The 2021 proxy season saw a record 488 ESG-related shareholder proposals,[116] and

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113 Southland Sod Farms v. Stover Seed Co., 108 F.3d 1134, 1145 (9th Cir. 1997) (quoting 3 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 27.04[4][d] at 27–54 (3d ed. 1992)).

114 *See, e.g.*, Lucian Bebchuk, *The Disney Verdict and the Protection of Investors*, FIN. TIMES (Aug. 12, 2005), http://www.pay-without-performance.com/FT-Disney_8.11.05.pdf.

115 17 C.F.R. § 240.10b-5(b) (2023) (which applies to untrue statements of material fact and material omissions).

116 *2021 Proxy Season Marked "New Era" of Shareholder Support for ESG Issues*, ESG INSIDER: PODCAST FROM S&P GLOBAL, at 00:36 (Oct. 29, 2021), https://esginsider.libsyn.com/2021-proxy-season-marked-new-era-of-shareholder-support-for-esg-issues.

such resolutions received a record level of support.[117] Institutional investors have played a pivotal role in directing this shift by taking clear public stances in support of business strategies attentive to climate change, diversity, and the fair treatment of employees.[118]

In view of the increased interest of traditionally passive investors in making corporations vehicles to promote social policy objectives, the SEC has recently signaled its intention to contribute to the area.[119] On August 6, 2021, for example, the SEC approved the Nasdaq Stock Market LLC's proposed rule change to adopt listing rules related to board diversity ("Board Diversity Proposal") and "to offer certain listed companies access to a complimentary board recruiting service to help advance diversity on company boards ("Board Recruiting Service Proposal")."[120] Moreover, on November 3, 2021, the SEC's Division of Corporation Finance published Staff Legal Bulletin No. 14L that explicitly outlines a change in the procedure adopted to screen shareholder

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117 *See* Press Release, Proxy Preview, Record Breaking Year for Environmental, Social, and Sustainable Governance (ESG) Shareholder Resolutions (June 24, 2021), https://siinstitute.org/press/2021/Proxy_Preview_20201_Press_Release_pdf; *see also* KATHY BELYEU ET AL., INSTITUTIONAL S'HOLDER SERVS., 2021 GLOBAL BENCHMARK POLICY SURVEY: SUMMARY OF RESULTS 5 (2021), https://www.issgovernance.com/file/publications/2021-global-policy-survey-summary-of-results.pdf.

118 Most notably, Larry Fink's 2018 letter to CEOs defined a new era of BlackRock's investment strategy. *See* Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 17, 2018), https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose/; *see also* BLACKROCK INV. STEWARDSHIP, BLACKROCK, INC., PURSUING LONG-TERM VALUE FOR OUR CLIENTS (2021); Cyrus Taraporevala, *2019 Proxy Letter—Aligning Corporate Culture with Long-Term Strategy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 15, 2019), https://corpgov.law.harvard.edu/2019/01/15/2019-proxy-letter-aligning-corporate-culture-with-long-term-strategy/.

119 *See, e.g.*, Lee, *supra* note 8. Compare this with Complaint at 2, Interfaith Ctr. on Corp. Resp. v. U.S. Sec. & Exch. Comm'n, No. 1:21-cv-01620 (D.D.C. June 15, 2021) that highlighted the detrimental consequences of the Commission's proposed amendments to Rule 14a-8 which "dramatically increase the amount of stock a shareholder must own to be eligible to submit a proposal, including a more than *ten-fold increase* for investments held for only one year. The amendments also prohibit shareholders from aggregating their holdings to meet the new requirements. Those changes will have a disproportionate impact on Main Street investors, for whom the proposal process is a critical mechanism for raising concerns."

120 Self-Regulatory Organizations, Exchange Act Release No. 34-92590 (Aug. 6, 2021) (order approving SR-NASDAQ-2020-081 and SR-NASDAQ-2020-082).

proposals under Rule 14a-8 of the Securities Exchange Act of 1934.[121] According to the announcement, the established interpretation of the "ordinary business" exception contained in Rule 14a-8(i)(7), which had significantly limited shareholders' chances to succeed in making proposals, should no longer preclude shareholder engagement on important matters.[122] Thus, while proposals will continue to be non-binding, boards' decisions to exclude shareholders ESG proposals will face increased scrutiny. In addition, greater emphasis is now going to be placed on ESG disclosures on companies' websites and SEC filings.

Furthermore, in March 2022, the SEC advanced a proposal on climate-related disclosures.[123] According to the proposed rules, which have already been highly criticized,[124] companies would have to integrate their public disclosures with information regarding governance and management of climate-related risks, as well as to the risk assessment methodology employed to identify material risks. Yet the most radical feature of the proposed new rule pertains to the objective of "establish[ing] certain requirements regarding the measurement and reporting of [greenhouse gas ("GHG")] emissions that would promote the comparability of such disclosure."[125] The proposed rule

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[121] SEC Staff Legal Bulletin No. 14L (Nov. 3, 2021). The Division of Corporation Finance rescinded Staff Legal Bulletin Nos. 14I (SEC Staff Legal Bulletin No. 14I (Nov. 1, 2017)), 14J (SEC Staff Legal Bulletin No. 14J (Oct. 23, 2018)), and 14K (SEC Staff Legal Bulletin No. 14K (Oct. 16, 2019)). The SEC had already shown signs of its new approach in March 2021. *See* Myles McCormick, *SEC Forces Oil Companies to Hold Investor Votes on Emission Targets*, FIN. TIMES (Mar. 20, 2021), https://www.ft.com/content/50b52600-dd43-427c-88a6-149cf790cb70.

[122] SEC Staff Legal Bulletin No. 14L, *supra* note 121. The announcement was welcomed by the Shareholder Rights Group. *See Shareholder Rights Group Hails New SEC Staff Legal Bulletin: Important Relief for Investor Rights*, S'HOLDER RTS. GRP. (Nov. 3, 2021), http://www.shareholderrightsgroup.com/2021/11/shareholder-rights-group-hails-new-sec.html ("We congratulate the Commission and staff for the new bulletin which will empower shareholders to pursue ESG proposals at their companies. ESG issues affect long-term value as well as posing externalities that may otherwise affect portfolio values. The new Staff Legal Bulletin is a laudable move by the SEC that should reduce costs and uncertainties for shareholder proponents as well as companies.").

[123] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (proposed Apr. 11, 2022) (to be codified at 17 C.F.R. 210, 229, 232, 239, and 249).

[124] *See, e.g.*, Hester M. Peirce, Comm'r, Sec. & Exch. Comm'n, We Are Not the Securities and Environment Commission – At Least Not Yet (Mar. 21, 2022), *in* SEC. & EXCH. COMM'N: SPEECHES AND STATEMENTS, Mar. 2022.

[125] The Enhancement and Standardization of Climate-Related Disclosures for Investors, *supra* note 123, at 21,374.

would require companies to report not only Scope 1[126] and Scope 2[127] emissions, but also "all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain" (*i.e.*, Scope 3 emissions).[128] According to some commenters, the inclusion of Scope 3 emissions in the newly designed mandatory disclosure regime should follow a more targeted approach (*i.e.*, limited to "certain industries, larger registrants, or when a registrant's Scope 3 emissions comprise 40 percent of its total emissions")[129] given the "difficulties in obtaining the necessary data from third parties and methodological uncertainties[.]"[130] To mitigate the concerns related to the extensive reach of the proposed rules, the SEC has outlined a binary approach, distinguishing between required disclosure of Scope 1 and Scope 2 emissions from the required disclosure of Scope 3 emissions. For the latter, the SEC would "require disclosure of Scope 3 emissions only if those emissions are material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions."[131]

A recent U.S. Supreme Court decision has cast a large shadow over the SEC's climate disclosure rule. In *West Virginia v. EPA*, the Supreme Court applied an exception to the *Chevron* doctrine,[132] the "major questions doctrine," to invalidate regulations that have "vast 'economic and political' significance" if they are not specifically authorized by Congress.[133] Since this characterization would also appear to apply to the SEC's proposed climate disclosure

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126 *Id.* (defining Scope 1 emissions as "direct GHG emissions from operations that are owned or controlled by a registrant").

127 *Id.* (defining Scope 2 emissions as "indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant").

128 *Id.* ("Upstream emissions include emissions attributable to goods and services that the registrant acquires, the transportation of goods (for example, to the registrant), and employee business travel and commuting. Downstream emissions include the use of the registrant's products, transportation of products (for example, to the registrant's customers), end of life treatment of sold products, and investments made by the registrant." (footnote omitted)).

129 *Id.* at 21,376 (footnotes omitted).

130 *Id.*

131 *Id.* at 21,377-78.

132 West Virginia v. EPA, 142 S. Ct. 2587 (2022). The *Chevron* doctrine generally holds that courts should defer to a federal agency's interpretation of an ambiguous statute if the statute is within the agency's scope of expertise. Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc., 467 U.S. 837 (1984).

133 Util. Air Regul. Grp. v. EPA, 573 U.S. 302, 324 (2014).

regulations, the SEC's efforts to address climate risks appear to be at significant risk of failure.

Regardless of the outcome of the climate disclosure rule, these latest moves represent an important signal of the SEC's openness in supporting what has been referred to as "*The New Paradigm*—a roadmap for an implicit corporate governance and stewardship partnership—based on the idea that corporations and shareholders can forge a meaningful and successful private-sector solution to attacks by short-term financial activists and the short-termism that significantly impedes long-term economic prosperity."[134] In particular, the expansion of disclosure requirements driven by the promotion of ESG objectives could become a promising avenue to achieve greater corporate accountability. Securities regulation, in fact, provides a number of enforcement mechanisms for violations of disclosure requirements that could offer alternative pathways to the actions available under corporate law.[135] However, while the "major questions doctrine" might hinder the enactment of regulatory initiatives, the "corporate optimism" doctrine represents an obstacle to legal enforcement actions against misleading ESG-related claims.

VII. NON-LEGAL INFLUENCES

The preceding sections have focused primarily on legal doctrine and enforcement mechanisms. What emerged from the analysis is that the present legal framework is not well-suited to serve interests that depart from the classic focus on shareholder value maximization. In fact, by using the available legal toolkit, shareholders and creditors in the context of bankruptcy proceedings

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[134] Martin Lipton et al., *It's Time To Adopt* The New Paradigm, WACHTELL, LIPTON, ROSEN & KATZ (Feb. 11, 2019), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.26357.19.pdf.

[135] More specifically, Item 303 of SEC Regulation S-K mandates issuers to disclose "any known trends or uncertainties that have had or that the [issuer] reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" and, in case of violation, actions can be brought by the SEC. Kobi Kastiel, *Regulation S-K Failure to Disclose Creates Liability Under Section 10(b)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 8, 2015), https://corpgov.law.harvard.edu/2015/02/08/regulation-s-k-failure-to-disclose-creates-liability-under-section-10b/; Hemel & Lund, *supra* note 14, at 1635-40; *see also id.* at 1636 ("The SEC can bring an enforcement action under either Regulation S-K or Rule 10b-5, but circuits are split as to whether there is a private right of action for a Regulation S-K violation."), In addition, private parties can bring actions for violations of Rule 10b-5. *Id.* at 1635 (noting how Rule 10b-5 "makes it unlawful for a company to utter 'any untrue statement of material fact' in connection with a securities transaction and 'to *omit* to state a material fact' that is necessary to render another statement 'not misleading.'").

have faced significant obstacles in holding businesses accountable for ESG-related failures.

Yet the legal framework represents only one part of the relevant setting for ESG enforcement given that private ordering, including the reputation mechanism, has historically played a central role in U.S. capital markets.[136] Undoubtedly, some companies will pursue ESG objectives for their reputational value.[137] While investor satisfaction with financial returns is likely to retain a primary role, the advent of stakeholder governance suggests that companies will have incentives to consider a broader set of constituencies. In fact, it is undeniable that the wave of initiatives and the shifting focus on ESG-sensitive issues has sparked corporate players' reactions towards implementing more virtuous policies. For instance, in California, reputational concerns have already led to significant changes in the composition of boards, even though the legal mandate has been paused due to the aforementioned constitutional challenges.[138]

An even more influential role has been played by institutional investors and proxy advisers, who have spoken out in support of ESG objectives. Most notably, Larry Fink started publicly advocating for more conscious business models in 2018.[139] His voice has later been echoed by representatives of other large institutional investors and public pension funds. While the actual impact of Fink's initiative has yet to be measured, there is no doubt that it has contributed to an increase in market players' attention on ESG as a whole. Finally, activist shareholders have mounted an increasing number of ESG-driven campaigns, which have been crucial accelerators towards more ESG-aware businesses. While Engine No. 1's 2021 campaign against Exxon Mobil

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136 *See generally* Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328, 2367 (2004) (discussing how private parties employ the reputational mechanism as a private ordering enforcement mechanism, "We instead observe private ordering accompanying private substantive law and with it the pervasive reliance on reputation mechanisms despite their significant costs.").

137 Susan Bokermann, *ANALYSIS: Corporate Reputation Is What Drives ESG Disclosures*, BLOOMBERG L. ANALYSIS (Nov. 8, 2021, 1:25 PM), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-corporate-reputation-is-what-drives-esg-disclosures.

138 Alisha Haridasani Gupta, *Another California Board Diversity Law Was Struck Down, But It Already Had a Big Impact*, N.Y. TIMES (May 19, 2022), https://www.nytimes.com/2022/05/19/business/california-board-diversity-women.html.

139 Fink, *supra* note 118.

is perhaps the most prominent example,[140] it is only one instance in which shareholder activism has lent momentum on ESG issues.

To this end, it is plausible that activist shareholders will continue succeeding in pushing companies to conform to more ESG-conscious standards of conduct. Activists appear more strategically sophisticated and skilled than other investors, which seems to have enabled them to achieve their objectives even by holding substantially less ownership compared to the past. Such circumstances might not be coincidental as increasing companies' social responsibility becomes the shared target among institutional investors. This trend seems destined to continue given that, without institutional investors exercising pressure on companies, the environmental and social changes that are advocated would require a much longer implementation time, have a narrower reach, and be subject to higher litigation risk.[141]

CONCLUSION

Corporate governance is undergoing an ESG-driven phase. But are the available enforcement actions adequate to effectuate real change? While corporate law foresees ways to enforce fiduciary duties, in practice, directors' liability is subject to very high judicial standards. The consequences unfold in the courtrooms where derivative suits rarely survive motions to dismiss or, if they do, are very often resolved through settlement agreements. Bankruptcy practices also allow for "global settlements" that might significantly limit creditors' actions against the debtor and its related parties. While enforcement actions under securities law could offer greater chances to pursue corporate accountability because of the closer relationship between ESG and mandatory disclosure, and between ESG and shareholder proposals, the "corporate optimism" doctrine deployed as a defense in securities litigation may hinder enforcement of ESG-related misstatements. Moreover, the latest regulatory initiatives on climate disclosure undertaken by the SEC are jeopardized by the Supreme Court's recent revival of the "major questions doctrine" limiting federal agencies' room for maneuver. Thus, enforcement of ESG objectives appears particularly difficult in light of the present legal framework.

Stepping back from this legal environment, what has emerged is the sense that a more responsible approach to capitalism is absolutely necessary in light

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140 Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html.

141 *See generally* Grundfest, *supra* note 55 (discussing risks associated with SB 862).

of the problems within the corporate world and beyond, together with the demands of investors. The current wave in favor of ESG goals may conceal a more profound demand that directors be held accountable for wrongdoing and business strategies that do not consider the impact on a broad set of stakeholders. Drawing on the theories on the cyclical nature of corporate governance, it is plausible that the emphasis on ESG values will continue to evolve, adjusting to underlying demands. Yet, whether the promotion of ESG values will emerge as the primary avenue for pursuing greater accountability in the corporate world remains to be seen.